Securities Industry Trends

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
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FIRST-HALF 1983: IF ONLY IT COULD CONTINUE!

HIGHLIGHTS

1. In the 1H 1983, annualized after-tax ROE was 31%, exceeding the record 26% for 1980. For full year 1983, we project ROE in the range of 24%-27%, near to or possibly exceeding the highest recorded figure since the mid-sixties.

2. Rising expenses remain of concern. Costs were masked by rapid revenue increases from 1979-1982 and declining interest rates during the 1H 1983. With revenues falling in the 3Q 1983, profits will decline sharply from the 1Q 1983 and 2Q 1983 levels.

3. Employment rose significantly in the securities industry during the 1H 1983. After rising by only 2.5% during 2H 1982, employment jumped nearly 11% to 194,300 by June 30, 1983 for NYSE firms dealing with the public.

4. With activity in the primary and secondary markets at unprecedented levels during the 1H 1983, firm catgories most dependent on this industry's core products -- origination and distribution of securities -- enjoyed the largest spurt in earnings.

5. We estimate that non-deposit taking discount brokers accounted for about 6.3% of retail commissions and 12.6% of retail share volume in 1982. During 1H 1983, discounters' market share amounted to 8.1% of retail commissions and 16.2% of retail share volume. However, their percentage of total industry revenues amounted to only 1.5% as compared to 1.3% in 1982.

6. For the first time in years, concentration in the securities industry declined. Firms other than the largest 25 saw their share of revenues and capital increase from 24% and 27% in 1982 to 26% and 34%, respectively, during 1H 1983.

Introduction

Our preliminary findings for the first half of 1983 were reported on October 12 in a presentation at the Vista Hotel. During that morning, we presented trends for the industry during the first half of 1983 as well as profitability and other trends for various firm categories from 1979 through the first half of 1983. In addition, we introduced the Securities Industry Data Base and explained how it can be used for comparing firm performances and describing trends in the securities industry.

This paper, including tables and graphs, represents a "fleshing out" of the October 12 presentation. In addition to our paper, there is a revised and updated list of discounters who are members of the NYSE, NASD, or both. Because of the widespread interest in trends in the discounter segment of the securities industry, we reviewed earlier listings of such firms and corrected mistakes which were made and included firms that had been inadvertently excluded. Much of the accuracy of our list depended on the cooperation of several discounters and vendors to such firms who have tracked firms in the discounter segment of the business. The discounter list is attached to this Trends issue.

In the June 1 issue, we noted that although recent years were extraordinarily good for the securities industry, there were areas of concern. For one thing, expenses grew at an annual compound rate of 26% from 1979-82. The escalating costs faced by the industry were masked by unusual revenue increases which were growing at a compound annual rate of 27% over the same time period. This led to the troublesome conclusion that if revenue growth fell below 27%, there would be a profit squeeze. Fortunately, revenue growth during the first half of 1983 surpassed even the extraordinary 27%, from 1979 to 1982. Revenues rose 31% on an annualized basis while expenses were increasing 23%. Unfortunately, the 23% increase in expenses, although down from the 1979 to 1982 trend, did not indicate that the industry was coming to grips with expenses. Rather, the industry enjoyed a respite from cost pressures because interest rates were falling, thereby cutting interest expense.

Industry Performance

Profitability

The securities industry has been highly profitable since 1979. In the first-half of 1983, annualized after-tax return on equity (ROE) was 31%, exceeding the record 26% established in 1980.

Securities Industry After-Tax Return on Equity,
1979 to First-Half 1983

1979	1980	1981	1982	First-Half 1983 (Annualized)
15.6%	25.7%	18.9%	21.3%	30.6%

Beginning with the third quarter of 1982, after-tax ROE reached an unprecedented level through the first half of this year. Indeed, the fourth quarter of 1982 may remain a high watermark for this industry in terms of a convergence of desirable market forces boosting industry revenues and profitability. The only period resembling the prosperity of the fourth quarter of 1982 for the securities industry was the second quarter of 1980 when annualized after-tax ROE reached 39%.

Quarterly Annualized After-Tax Return on Equity,
1Q 1982-2Q 1983

1982					1983		
I	II	III	IV	Year	I	II	Half-Year
5.4%	9.0%	28.4%	42.8%	21.3%	29.8%	31.2%	30.6%

Revenues

This jump in profitability in the 1H 1983 is partially explained by the spurt in total revenue. On an annualized basis, revenues rose 31% relative to 1982 (Table 1). The climb in industry revenue occurred essentially because of lower interest rates compared to 1982 and expectations that rates would not rise substantially (Table 2). Nevertheless, there remained some concern over interest rates because M1 growth exceeded the Federal Reserve's target range while GNP accelerated in the second quarter at an annualized real rate of 9.7%.

Various revenue sources grew at different rates during the 1H 1983. From 1981 to 1982, only margin interest revenues showed a decline. This decline continued during the 1H 1983. Other-related revenue, which was the fastest growing revenue source from 1979-82 -- 50% -- actually fell 2% during the 1H 1983 (see Charts I and II). Commissions, in particular, showed the most improvement in revenue growth during the 1H 1983. Whereas commissions rose 14% at a compound annual rate from 1979-82, this revenue source rose almost 50% on an annualized basis during the 1H 1983.

Table 1

Securities Industry Revenue Breakdown, 1982 and First-Half 1983
(Millions of Dollars)

	1982		1H 1983	
REVENUES*	Dollars	% of Total	Dollars	% of Total
Commissions				
Listed Equities on an Exchange	$ 4,492.0	19.3%	$ 3,305.6	21.8%
Listed Options	741.0	3.2	415.1	2.7
All Other	792.0	3.4	785.2	5.1
Total	6,025.0	25.9	4,506.0	29.7
Trading Profits				
Market Making OTC	658.0	2.8	810.2	5.3
Debt Securities	4,463.0	19.2	2,393.8	15.8
All Other	839.0	3.6	533.3	3.5
Total	5,960.0	25.7	3,732.6	24.6
Investment Profits	598.0	2.6	480.3	3.2
Underwriting				
Equity Securities	330.0	1.4	367.6	2.4
Total	2,322.0	10.0	1,852.6	12.2
Margin Interest	2,016.0	8.7	860.7	5.7
Mutual Fund Sales	290.0	1.2	602.8	4.0
Account Supervision	359.0	1.5	245.3	1.6
Research	25.0	0.1	9.3	0.1
Commodities	669.0	2.9	436.9	2.9
Other - Related	3,945.0	17.0	1,933.4	12.7
Other - Unrelated	1,051.0	4.5	518.7	3.4
GROSS REVENUE	$23,244.0	100.0%	$15,179.0	100.0%

* Discrepancies may exist due to rounding.

Source: Securities Industry Data Base

Table 2

Selected Interest Rates and Inflation Indexes,
Second-Half 1982 and First-Half 1983

	Interest Rates				Inflation Indexes	
	Federal Funds	3 to 5 Year Governments	New AAA Bonds	20 Year Governments	Producer Price Index*	Consumer Price Index**
1982:III	11.01%	13.00%	14.09%	12.94%	6.4%	7.6%
1982:IV	9.29	10.31	11.07	10.72	4.2	2.0
1983:I	8.65	9.95	11.22	10.87	(2.6)	(0.4)
1983:II	8.80	10.07	10.58	10.81	0.8	4.2

* Producer Price Index - Finished Consumer Goods
** Consumer Price Index - All Urban Consumers

Volume and share prices rose during the 1H 1983. Average daily share volume on the NYSE, AMEX and NASDAO totaled 104 million in 1982, but climbed to 163 million shares in the 1H 1983 (Table 3). The Dow Jones Industrial average which ended 1982 at 1046.54 increased nearly 17% to 1221.96 by the end of the 1H 1983. Volume climbed because of both institutional and retail customers' participation. Blocks of 10,000 shares or more as a percentage of NYSE reported volume, an indicator of institutional activity, rose to nearly 44% of public volume or 4.8 billion shares during the 1H 1983 compared to 41% or 6.7 billion shares for all of 1982. Increased interest by retail investors was reflected by NASDAO activity which doubled from an average of 33 million shares per day in 1982 to nearly 66 million shares in the 1H 1983.

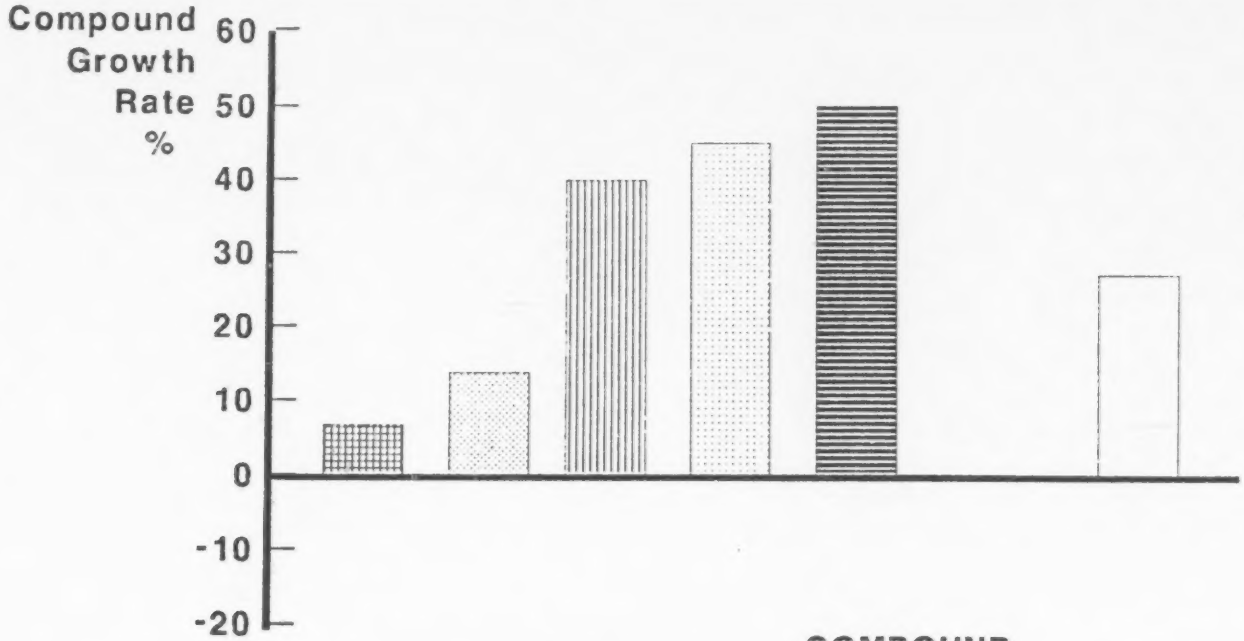
Table 3

Average Daily Share Volume, 1982 and First-Half 1983
(In Millions of Shares)

	1982		First-Half 1983	
	Shares	Percent	Shares	Percent
NYSE	65.1	62.8%	88.1	54.0%
AMEX	5.3	5.1	9.5	5.8
NASDAO	33.3	32.1	65.6	40.2
	103.7	100.0%	163.1	100.0%

Chart I

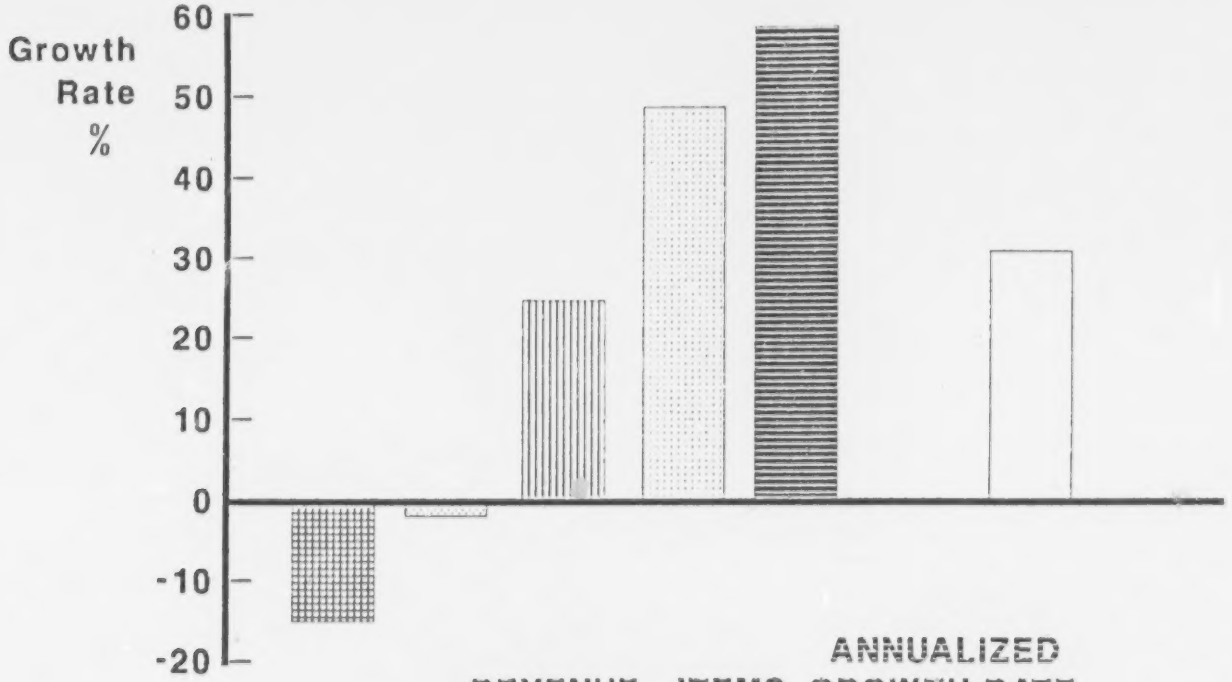
COMPOUND GROWTH RATES OF REVENUES, 1979-1982



REVENUE ITEMS	COMPOUND GROWTH RATE
MARGIN INTEREST	7 %
COMMISSIONS	14
TRADING	40
UNDERWRITING	45
OTHER RELATED	50
TOTAL REVENUE	27 %

Chart II

ANNUALIZED GROWTH RATES OF REVENUES, FIRST-HALF 1983



REVENUE ITEMS	ANNUALIZED GROWTH RATE
MARGIN INTEREST	(15) %
OTHER RELATED	(2)
TRADING	25
COMMISSIONS	49
UNDERWRITING	59
TOTAL REVENUE	31 %

Trading Profits

The increase in trading profits, one of the fastest growing revenue sources from 1979-1982, slowed down in the 1H 1983. Such profits climbed 40% in 1982 compared to an annualized rate of 25% during the 1H 1983. As a result, it fell from being as large a revenue source as commissions in 1982, to second in importance for the 1H 1983. Debt instruments, the largest component of trading profits, generated profits rising at an annualized rate of only 7% (Table 4) because interest rates were relatively stable in the 1Q 1983 and rose during the 2Q 1983.1/ However, trading profits from OTC market-making activities soared at an annualized rate of 146% as the NASDAQ Composite Price Index, after reaching its trough of 167.35 in July 1982, spurted to 318.70 by June, 1983.

Table 4

Securities Industry Trading Profits
(Millions of Dollars)

	1982 Year		1983 I		1983 II		1983 First Half		Annualized Percent Increase, 1982 to 1H 1983
	$	% of Total	$	% of Total	$	% of Total	$	% of Total	
Market Making OTC	$ 658	11.0%	$ 355	18.1%	$ 455	25.7%	$ 810	21.7%	146.3%
Debt	4,463	74.9	1,366	70.0	1,058	59.8	2,394	64.1	7.2
Options on Nat'l Exch.	7	0.1	12	0.6	27	1.5	39	1.0	1000.1
Other	735	12.3	266	13.5	229	12.9	494	13.2	18.3
Total	$5,960	100.0%	$1,964	100.0%	$1,769	100.0%	$3,733	100.0%	25.3%

Underwriting

Underwriting revenue climbed at a 59% annualized rate in the 1H 1983 after increasing by 45% in 1982. Corporate financings reached an annual high in 1982 at $79 billion. However, this total will be swamped in 1983 with $61 billion worth of offerings already completed by June 30, 1983. Of the $61 billion,

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1/ Interest received on debt positions contributed to this slowdown since trading profits reported on FOCUS include accrued interest and rates were at a lower level in 1983 relative to 1982.

Table 5

Corporate Underwriting Activity, 1982 and First-Half 1983*
(In Billions of Dollars)

	1982		First-Half 1983	
	Dollars	Percent	Dollars	Percent
Common Stocks	$16.5	20.9%	$22.2	36.3%
Preferred Stocks	5.3	6.7	5.8	9.4
Bonds	57.2	72.4	33.2	54.3
	$79.0	100.0%	$61.1	100.0%

* Includes all underwritten Yankee bonds and Alaska State Housing taxable securities.

Source: Directory of Corporate Financing, Dealers' Digest Inc., 1982 and Semi-Annual 1983.

$33 billion in debt was raised with just under $15 billion coming from issues registered under Rule 415. The remainder was comprised of $5.8 billion from preferred stock sales and $22.2 billion generated by common stock offerings. Particularly impressive was the value of money raised via initial public offerings, IPOs (Table 6).

Table 6

Initial Public Offerings
(000's omitted)

First Half	Amount	No. of Issues
1983	$4,568,241	243
1982	719,256	129
1981	2,214,585	282
1980	446,661	96
1979	254,858	59

Source: Directory of Corporate Financing, Dealers' Digest Inc., September 1983, p. 17.

The high level of activity persisted because of the decline

in the cost of capital and the need by companies to restructure their balance sheets. Corporations had taken on an unusually high proportion of short-term debt in recent years because of high interest rates and low equity prices. At the end of 1982, nonfinancial corporate business liabilities included nearly 49% of short-term debt/credit market debt, an historical high. The increased reliance on equity offerings -- 46% of all underwriting for the 1H 1983 -- (28% in 1982) was particularly significant.

Margin Interest

Margin interest revenue fell 15% in the 1H 1983 after plunging 30% in 1982. However, the important variable for firm profits is not gross margin interest revenue but net margin interest income which cannot be calculated because of the limited available data. Nevertheless, data are available for NYSE customer margin debit balances, estimated rates charged margin customers, the broker call rate, and free credit balances. Although data are not available on cash debits against which free credit balances are also used or revenue earned on stocks bought on margin, the available data might indicate the trend in net margin interest income. Firms may not have been as adversely affected in 1982 as reflected by the drop in gross margin interest revenue because while margin debit balances decreased 15%, free credit balances rose nearly 30% (Table 7). As a result, net margin interest income may have risen while gross margin interest revenue fell. Since customer margin debit balances climbed 25% while free credit balances increased 23% during the 1H 1983, net margin interest income probably increased.

Table 7

Indicators of Net Margin Interest Income*
(In Billions of Dollars)

	NYSE Customer Margin Debit Balances	Free Credit Balances	Average Broker Call Rate	Estimated Rate Charged Margin Customer
1981	$14.20	$ 9.04	17.85%	19.35%
1982	12.04	11.65	13.43	14.90
1H 1983	15.08	14.36	9.70	11.05

* All data are averages.

Other-Related

Other-related revenues to the securities business include interest on repos, M&A fees, private placement fees, and other sources. These revenue sources declined at an annualized rate of

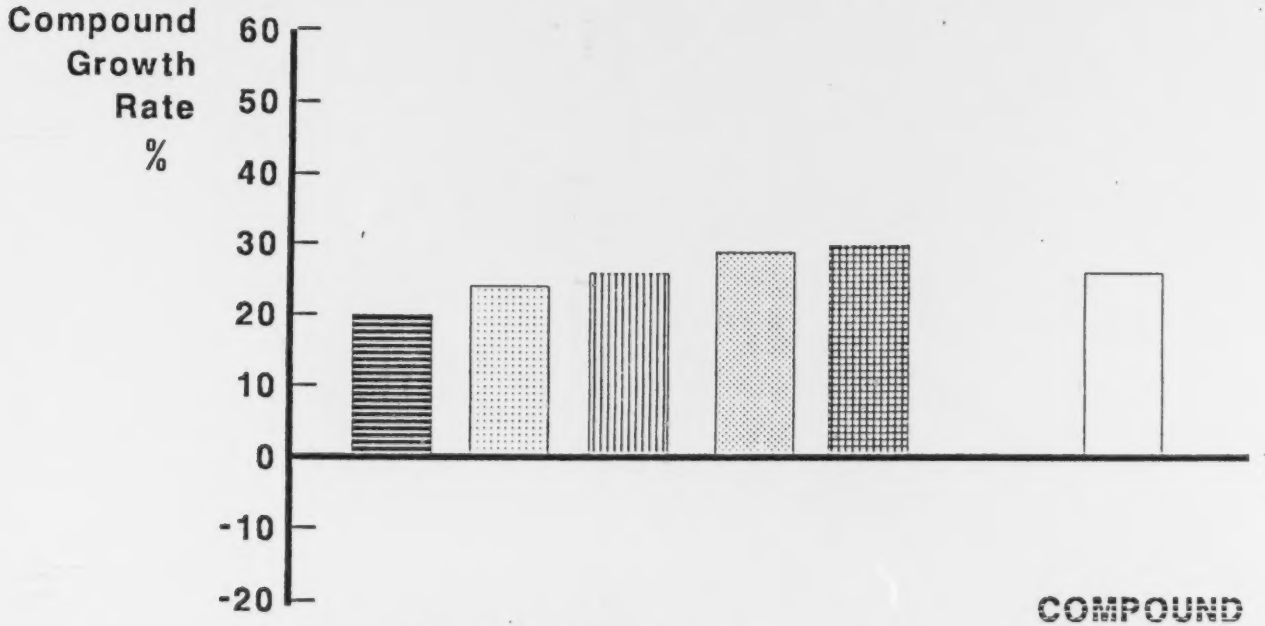
2% in the 1H 1983 after climbing 33% in 1982. Interest on repos is believed to be the largest component of this revenue item and is probably responsible for the decrease as interest rates fell. However, just like net margin interest income, net interest income on repos is the important concept rather than gross interest figure because much of the repo business is based on matching transactions between lenders and borrowers. The annualized increase for the 1H 1983 for fees from both M&A activities as well as private placements probably exceeded those for 1982. M&A activity, as reported by W.T. Grimm, was $31.4 billion during the 1H 1983 compared to $53.8 billion for all of 1982, and private placements amounted to $12.4 billion during the 1H 1983 compared to $19.9 billion in 1982.

Expenses

Expenses were escalating nearly as fast as revenues during 1979-1982, and, as indicated in the June, 1983 Trends issue, threatening industry profitability (Chart III). The difference between revenue and cost increases widened during the 1H 1983 boosting ROE to a record level. Revenue increased at an annualized rate of 31% while expenses rose 23% (Table 8). However, the increase in costs is masked by declining interest costs (Chart IV). Interest costs were the only expense to decrease, falling 9% at an annualized rate. Excluding interest expense, total costs climbed at an annualized rate of 35%. However, lower interest rates also reduce certain revenue sources. Total revenue, excluding margin interest, also increased at an annualized rate of 35%. Unfortunately, other interest-related revenue sources such as interest on repos and fixed income instruments carried as inventories cannot be computed from FOCUS data. Thus, we are unable to adjust revenue trends for interest rate fluctuations to analyze the underlying cost trends relating to revenues. Nevertheless, the limited adjustment for interest rate fluctuations continues to support our concern over costs.

Chart III

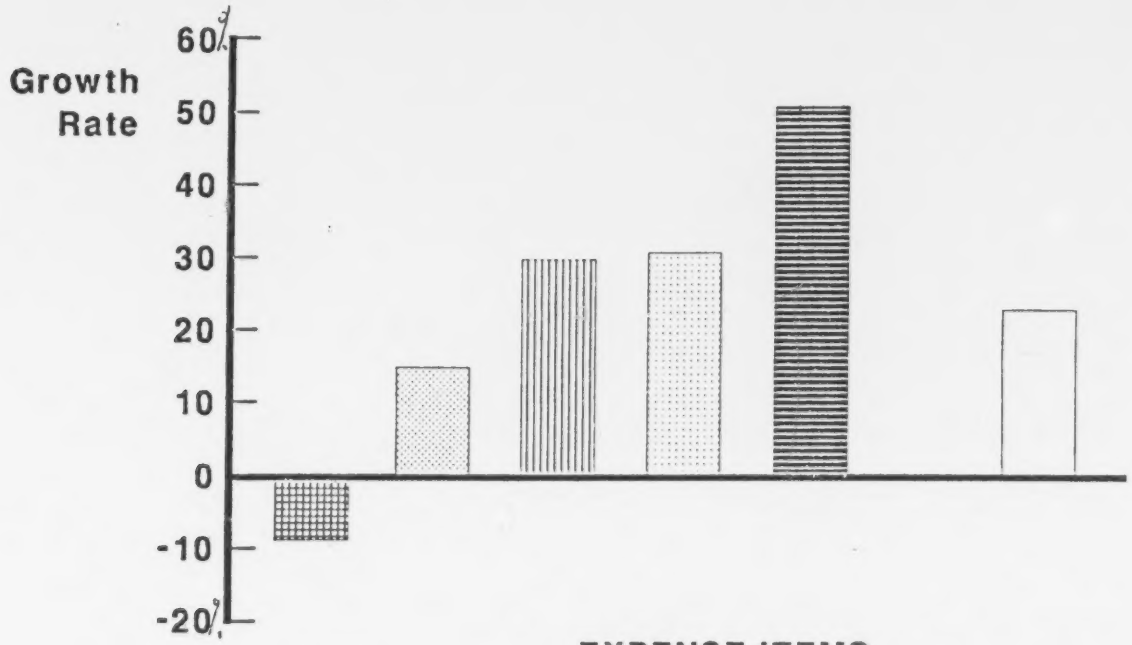
COMPOUND GROWTH RATES OF EXPENSES, 1979-1982



EXPENSE ITEMS	COMPOUND GROWTH RATE
INTEREST	20%
COMMUNICATIONS	24
ADMINISTRATIVE & CLERICAL EMPLOYEE EXPENSES	26
REGISTERED REP. COMPENSATION	29
OTHER	30
TOTAL EXPENSES	26%

Chart IV

ANNUALIZED GROWTH RATE OF EXPENSES, FIRST-HALF 1983



EXPENSE ITEMS	ANNUALIZED GROWTH RATE
INTEREST	(9) %
COMMUNICATIONS	15
ADMINISTRATIVE & CLERICAL EMPLOYEE EXPENSES	30
OTHER	31
REGISTERED REP. COMPENSATION	51
TOTAL EXPENSES	23 %

Table 8

Securities Industry Expense Breakdown, First-Half 1983*
(Millions of Dollars)

EXPENSES	Dollars	Percent of Revenue	Annualized Percent Increase
Floor Brokerage & Clearance	$ 530.8	3.5%	21.1%
Registered Rep. Compensation	3,106.2	20.5	51.0
Clerical & Administrative	2,421.7	16.0	30.5
Communications	735.8	4.8	15.4
Occupancy & Equipment	530.2	3.5	23.9
Promotional Costs	329.9	2.2	23.8
Interest	2,494.7	16.4	(8.9)
Losses in Error Accts. & Bad Debts	125.8	0.8	28.4
EDP Equipment Costs	161.0	1.1	17.0
Regulatory Fees & Expenses	60.7	0.4	17.9
Partners' & Voting Stockholders' Salaries	501.0	3.3	31.3
Other	1,141.3	7.5	32.0
Total	$12,416.4	81.8%	23.1%

* Discrepancies may exist due to rounding.

Source: Securities Industry Data Base

Significant increases occurred in variable as well as so-called fixed costs although the latter showed some signs of slowing down. Registered representative compensation jumped by an annualized 51%. Since account executives are compensated from three different revenue sources -- commissions, underwriting, and principal activities -- it is impossible to determine the payout ratio from FOCUS. Clerical and administrative expenses, a hybrid item which includes both variable and fixed costs, rose at the same rate as total revenue. Employee expenses climbed at a high rate compared to revenues. A jump in total employment significantly contributed to this higher cost. Employment for NYSE firms dealing with the public, excluding introducing firms,2/ rose only 2.5% during the last six months of 1982 to 175,600. During the first-half of 1983, employment climbed nearly 11% to 194,300. Apparently, the industry was slow to hire additional employees during the first stages of the recovery. As the boom in volume and security prices continued, employees were added. Among the so-called fixed costs, large annualized increases continued although below their 1979-1982 increases. Occupancy and equipment, communications, and EDP equipment expenses all rose at slower

2/ No data on employment trends are required on FOCUS for such firms.

rates in 1983 relative to 1979-82.

Other Industry Trends

Volatility

As indicated, the securities industry remains volatile in terms of profitability swings. Of the 17 quarter-to-quarter swings in ROE since 1979, 10 were in an upward direction while 7 were down (see Chart V). A key factor causing this volatility, of course, is the swing in total revenue from quarter to quarter. In just examining the 1Q 1982-2Q 1983, a comparison of the troughs and peaks by revenue source shows that total revenue was up over 75% when comparing the high (2Q 1983) with the low (1Q 1982). Individual revenue sources were even more volatile. The peak in underwriting was almost three times the trough. For trading, the peak was almost twice as large as the trough and for commissions, it was more than twice the low for that revenue source. Of the five revenue sources analyzed, two peaked in the 2Q 1983, two in the 4Q 1982, and one during the 1Q 1982. Given the volatility of various revenue sources, it is not surprising that total revenue also fluctuates widely from quarter to quarter, thereby causing sharp swings in ROE.

Impact of Interest Rates

Recently, some individuals in the industry noted that, since the securities industry performed well in a period of relatively high interest rates and inflation, a drop in interest rates may hurt rather than help the securities industry. Clearly, such comments are incorrect. The industry enjoyed a boom in profitability with the drop in interest rates starting with the second half of 1982. Profitability has since soared, reaching an unprecedented level for four consecutive quarters starting with the third quarter of 1982.

Expenses as well as revenues are affected by changing interest rates. From 1979 to 1982, total expense grew at a compound annual rate of 26% with interest cost increasing at a rate of 20%. Meanwhile, total revenue annually increased 27%. During the first-half of 1983, total annualized costs were up 23% as interest cost dropped 9%. Total revenue climbed 31%. If not for the decline in interest cost, annualized total expense would have risen 35% during the first-half of 1983.

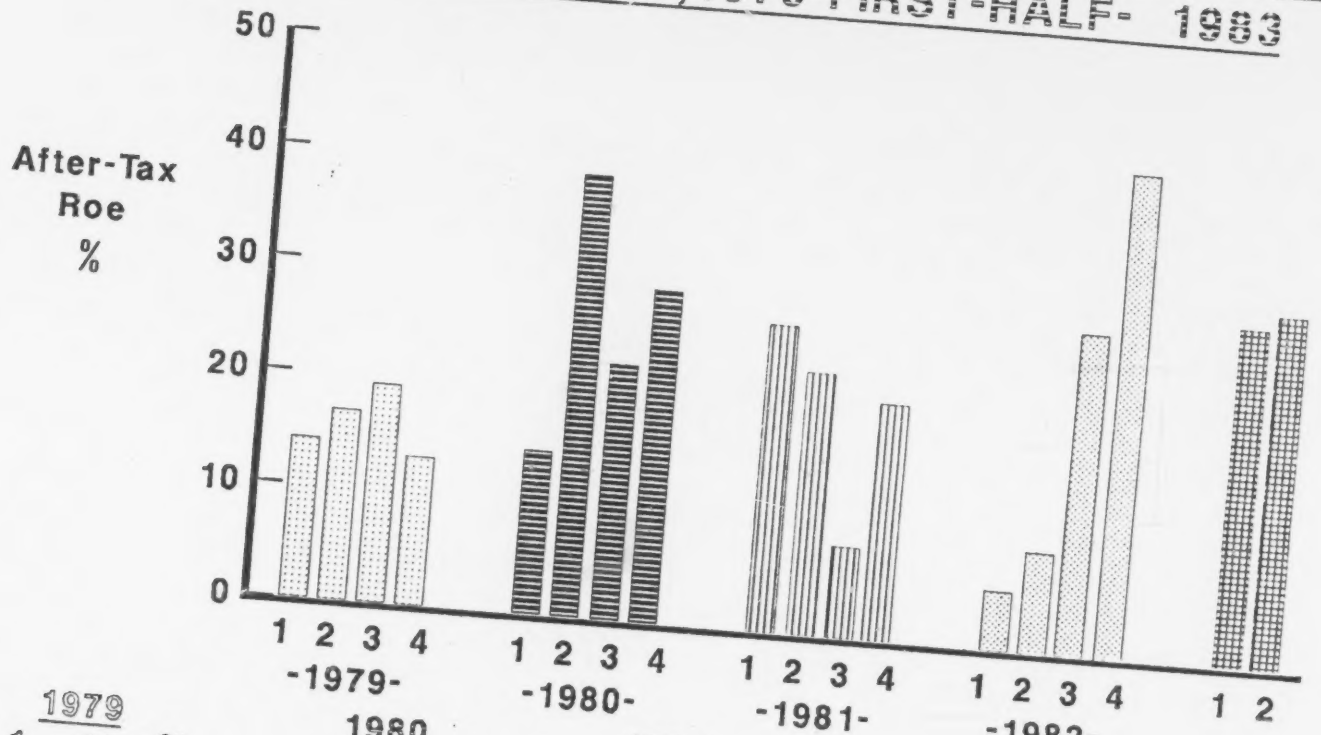
Given the fact that the decline in interest rates spurred securities prices and volume, new offerings of debt and equity, and caused a decline in the growth of costs, lower interest rates are crucial to the profitability of the securities industry.

Outside Capital

The impressive ROE figures are attracting "outsiders." In recent years, other financial intermediaries have shown a growing

Chart V

SECURITIES INDUSTRY QUARTERLY ANNUALIZED AFTER-TAX RETURN-ON-EQUITY, 1979-FIRST-HALF- 1983



interest in the securities industry's profitability and have sought to obtain entry into this industry, either through direct purchase or de novo entry. Insurance companies, in particular, have linked up with securities firms and commercial banks have been aggressive in pursuing additional investment banking business as well as securities brokerage. Of course, these appetites may undergo a dramatic change if and when hard times fall on this industry as in the early 1970s. At that time, there was little interest by outsiders in an industry that was starving for capital and seeing its revenue sources contracting.

Firm Categories

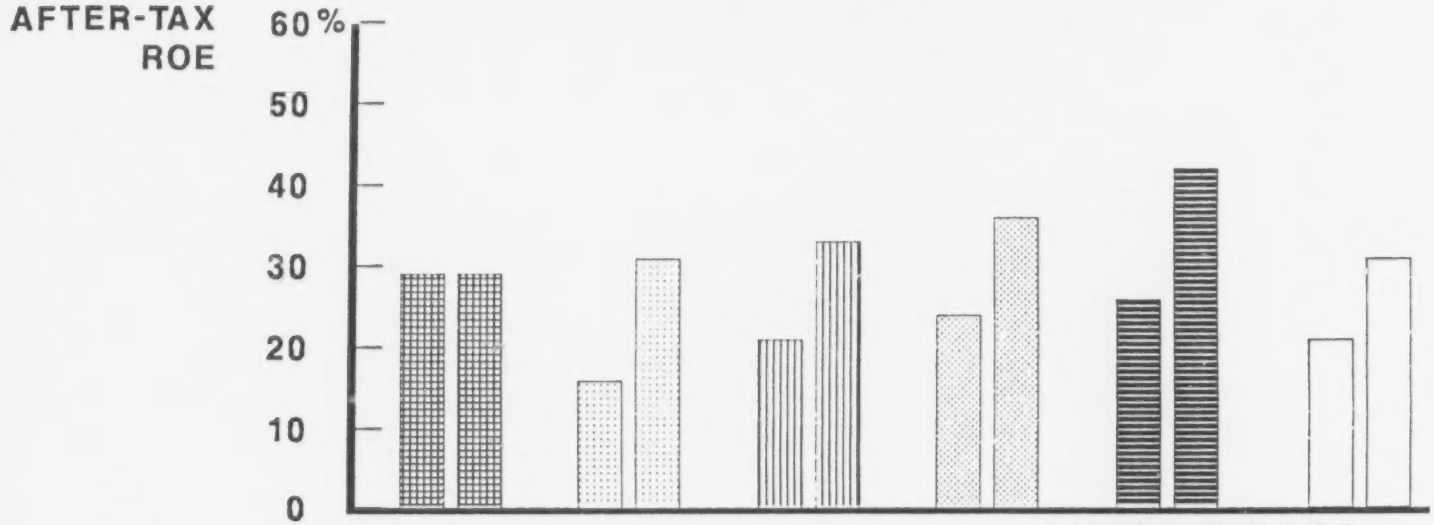
Those firm categories least dependent on traditional core products of this industry -- origination, distribution and selling of securities -- were the most profitable in 1982. During the first half of 1983, the reverse was true. Those firms most dependent on traditional core products were most profitable, while those emphasizing other products and services showed the least improvement from 1982.

When conditions in the securities markets are strong, all firm categories prosper. Likewise, when conditions in the financial markets deteriorate, all firm categories suffer to some extent, although one group may fare better than others. In other words, much of the performance of the industry and, in particular, individual firms, may be outside management control. Nevertheless, with revenue growth slowing down in the third quarter, more and more firms are focusing on the need to control costs. It is frustrating for management to scrutinize every expense item closely and to make strenuous efforts to gain additional or, at least, retain market share while much of what affects a firm's profitability is outside its direct control. This is particularly true when monetary policy in the country undergoes an abrupt change or fiscal policy is unbalanced because of spending and taxation policy. Nevertheless, the overall profitability in this industry from 1979 through the 1H 1983, when most other sectors of the economy were buffetted by inflation and low or zero growth, augers well for the creativity, flexibility and judgment of industry leaders.

Last year, the securities industry earned an estimated 21% ROE after income taxes. This represented a remarkable turnaround given that annualized ROE for the first and second quarters were 5.4% and 9.0%, respectively. With the market rally igniting in mid-August, all elements of the securities industry enjoyed a surge in profitability. For the year, the large investment bankers received the highest ROE (29%) compared to the low for national full line firms (16%) (see Chart VI). Following the large investment bankers were discounters (26%), New York City regional firms (24%), and regionals (21%). All of these categories, except the large investment bankers, enjoyed a substantial increase in ROE during the first half of 1983. The national full line firms almost doubled their ROE from 16% in

Chart VI

AFTER-TAX RETURN-ON-EQUITY BY FIRM CATEGORY, 1982 AND FIRST-HALF 1983



FIRM CATEGORIES	AFTER-TAX ROE 1982	AFTER-TAX ROE FIRST-HALF 1983 ANNUALIZED
LARGE INVESTMENT BANKING	29%	29%
NATIONAL FULL-LINE	16	31
REGIONALS	21	33
NEW YORK CITY	24	36
DISCOUNTERS	26	42
SECURITIES INDUSTRY	21%	31%

1982, to 31% for the first-half of 1983. Only the largest investment bankers did not show any increase, but their ROE of 29% during both of these periods was nothing to sneeze at. On a relative basis, the rankings of all firm categories improved by 1, except the large investment bankers who fell from #1 in 1982 to #5 during the first half of 1983. With activity in the primary and secondary markets at unprecedented levels, those firms most dependent on volume and security prices enjoyed the largest spurt in earnings.

Earlier, we noted that macro factors affect all firms in the securities industry in much the same manner (Chart VII). Almost all firm categories had their ROE trough in the 1Q 1982. Conversely, the ROE peak for all firms was the 4Q 1982. Of all the firm categories, the large investment banking firms had the smallest difference between their ROE trough and peak. Their lowest annualized ROE during this time period was 15.2% in the 1Q 1982 compared to their high of 43.8% during the 4Q 1982. With an ROE of 66.6% by discounters during the 4Q 1982, it is not surprising to find outsiders rushing into the discount brokerage business. The performance of the discount segment closely tracks that of the New York City area firms. These two firm categories are more dependent on the commission business, particularly from retail customers. Their clientele tends to be the more sophisticated, active trader.

Discounters

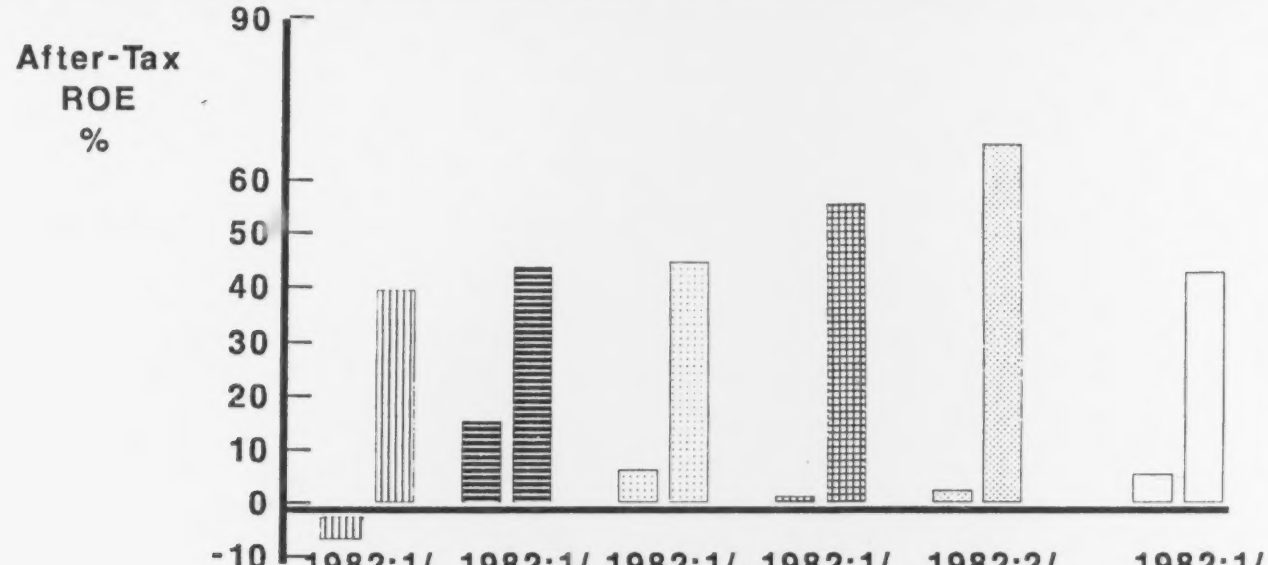
There continues to be widespread interest within and outside the securities industry about discounters. Because of this, as in other issues of Trends, we thought it helpful to provide revenue data for the discounter category. Unfortunately, our data are limited to discounters that are members of the NYSE. However, with the cooperation of the NASD, we obtained aggregate figures on those sole NASD members who are discounters. Thus, we estimated trends in market share of discounters relative to other firms in the securities industry. At some time in the near future, we expect to provide detailed data on all discounters, whether or not they are members of the NYSE or NASD.

Unfortunately, there are no available data on the activities of deposit-taking institutions who provide discount brokerage services through their banking organizations. This is a glaring problem, particularly for the regulatory agencies who are responsible for reviewing and deciding on the permissible activities of deposit-taking institutions and securities firms. Such data are becoming more essential given the recent SEC release requesting comments concerning that agency's proposal to regulate the securities activities of banks. Simply put, there are no reliable numbers on the level of activity in discount brokerage provided by deposit-taking institutions.

Compiling an accurate and thorough discounter list is a painstaking task. Although a list was compiled by the SEC for their annual "Staff Report" on the Securities Industry, we found

Chart VII

LOW AND HIGH QUARTERLY ANNUALIZED AFTER-TAX RETURN-ON-EQUITY BY FIRM CATEGORY, 1982-FIRST-HALF 1983



	LOW	HIGH
NATIONAL FULL-LINE	(0.9)%	35.5%
LARGE INVESTMENT BANKING	15.2	43.8
REGIONALS	6.2	44.7
NEW YORK CITY	1.4	55.5
DISCOUNTERS	2.4	66.6
SECURITIES INDUSTRY	5.4 %	42.8 %

errors in the inclusion of many firms and others which were inadvertently excluded. Because of these problems, some of the conclusions contained in the SEC staff reports about discounters are incorrect. In particular, there are mistakes in profitability reported for NYSE discounters relative to other NYSE firms dealing with the public. Although there remains some problems with market share trends of discounters, those estimates are of less concern relative to the profitability comparisons.

We believe such errors have been eliminated by our attempts to compile a new discounter list. In particular, we relied on several discounter firms to review our list and note firms that were omitted or incorrectly included. Without such cooperation, we would be less confident in our results. We believe the profitability data and income statement for NYSE discounters is accurate and our estimates of market share for all non-deposit taking discounters is as accurate as possible given data limitations.

In the past, individuals interested in trends in discount brokers relied on the annual SEC staff reports on the securities industry. The 1979 and 1980 staff reports, in particular, displayed data on discount brokers, their profitability, revenue growth and comparison with other segments of the securities industry. With completion of the 1980 report, the SEC reduced its reporting on trends in the securities industry because of budget limitations. Since the 1980 report, SIA has attempted to fill this vacuum by analyzing trends for discount brokers as well as their market share in terms of retail commissions and retail share volume.3/ Unfortunately, our detailed analysis of discount brokers is restricted to trends beginning with the first quarter of 1982. Since our detailed information on discounters and other securities firms are limited to NYSE members, there were not enough discounter members of the NYSE before 1982 to warrant analyzing this group. With the cooperation of the NASD, we supplemented our detailed information of NYSE discounters with aggregate information for sole NASD discount brokers. Thus, we can provide a detailed income statement for NYSE discount firms and an analysis on the market share of all discounters including NASD sole members.

In reviewing the earlier SEC reports on profitability, their estimates show discounters with ROEs considerably higher than other firm categories. Because of errors in the original SEC list, we believe their analysis is flawed. Our figures show discounters were more profitable in 1982 and in the 1H 1983 relative to the rest of the industry. Nevertheless, these profitability comparisons do not show discounters considerably above other categories but rather close to that of New York City

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3/ Our first attempts at doing this were reflected in the March 4, 1983 issue of Trends entitled "A Primer on Discount Brokerage" as well as our update on 1982 published in June, 1983.

based regional firms. Given the revenue sources for these groups, it is logical that both discounters and New York City based regionals have similar profitability patterns. Commissions rose from nearly 70% of discounters' total revenue in 1982 to almost 80% for the 1H 1983 (Table 9). Meanwhile, although expenses climbed 62% in 1982 and 50% for the 1H 1983 on an annualized basis, these increases were less than those for revenues. Profitability gains were particularly impressive. Pre-tax profit margins improved from 13% in 1982 to nearly 19% for the 1H 1983. After-tax ROE rose from 26% in 1982 to 42% for the 1H 1983 on an annualized basis.

Table 9

NYSE Discounters' Income Statement
(In Millions of Dollars)

	1982		First-Half 1983	
	Dollars	Percent of Total	Dollars	Percent of Total
Commissions	$153.0	68.9%	$139.0	78.0%
Trading Profits	1.9	0.9	2.9	1.6
Underwriting	2.0	0.9	1.2	0.7
Margin Interest	37.0	16.7	14.9	8.4
Other - Related to Securities Business	10.1	4.5	9.8	5.4
All Other	18.2	8.2	10.4	5.8
Total Revenues	$222.2	100.0%	$178.2	100.0%
Net Income Before Taxes	$ 29.8		$ 33.4	

Source: Securities Industry Data Base

Discounters' market share of commissions also increased. The NYSE and NASD discounters received $244 million in commissions in 1982, compared to $7.1 billion for all firms dealing with the public. In terms of total revenue, discounters received $363 million as compared to $27.3 billion for the entire industry. In the 1H 1983, commissions received by discounters amounted to $193 million compared to $5.3 billion for the industry. Discounters received $261 million in total revenue compared to $17.8 billion for all NYSE and NASD members dealing with the public.

Table 10

NYSE and NASD Discounters' Market Share,
1982 to First-Half 1983
(In Millions of Dollars)

	1982	1H 1983
Industry Commissions	$7,091	$5,283
Estimated Retail Commissions	$3,091	$2,377
Discounters' Commissions	$244	$193
Discounters' Market Share of Retail Commissions	6.3%	8.1%
Industry Gross Revenues	$27,336	$17,803
Discounters' Gross Revenue	$363	$261
Discounters' Market Share of Gross Revenues	1.3%	1.5%

When analyzing the discounter category, most individuals are interested in their share of retail commissions and retail share volume. Unfortunately, there is no recent breakdown available on the proportion of commissions generated by retail versus institutional accounts. To estimate market share, we used a proxy for retail and institutional activity.4/

We esimated that retail commissions accounted for 55% in total commissions for 1982, but only 45% for the 1H 1983. By assuming that all discounter commission revenues is derived from retail activity, we estimate that discounters received 6.3% of retail commissions in 1982 and 8.1% in 1H 1983. If we assume discounters charge about half the rate of full service firms, they accounted for about 12.6% of retail activity in 1982 and

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4/ The last year for which the SEC collected data on commission rate charges for institutional and retail orders was 1981. To estimate this proportion for 1982 and the first half of 1983, we used the following methodology: first, we subtracted 10,000 share blocks and member trading as a percentage of NYSE volume. We took the ratio of "retail" volume to total NYSE volume in 1981 and compared that to the breakdown available for the SEC survey -- 65% of total commissions were generated from retail activity and 35% from institutional trading. We assumed that the same ratio would more or less hold for later periods. In other words,

$$\frac{\text{"Retail NYSE activity in 1981"}}{\text{"Retail NYSE activity in year Y"}} : \frac{.65}{X}$$

16.2% during the 1H 1983.

As indicated in the March 1983 Trends issue, although discounters are increasing their market penetration in the retail commission business, their share of the total revenue pie in the securities business is considerably smaller. Although discounters have increased their market share of retail commissions and share volume, their market share in terms of total securities revenue hardly changed at all. Their $363 million in revenues in 1982 amounted to only 1.3% of the industry's 1982 total revenue. During the first half of 1983, this percentage increased slightly to 1.5%. Because broker-dealers have diversified substantially in recent years and introduced a vast array of new products and services, the penetration of discount brokers in the total activities of the securities industry remains relatively small.

There continues to be no evidence of economies of scale in the securities industry in terms of profitability. In 1982, the smaller firms outperformed the larger firms. In 1983, with the vigorous rise in activity during the first half, smaller firms continued to outperform the larger firms. Of course, given the smaller number of firms in the top 10 or in group 11-25, a few relatively less profitable concerns will drag down the profitability for the group as a whole.

Table 11

After-Tax Return on Equity, by Firm Size

	1982	Annualized 1H 1983
Top 10	21.5%	28.4%
11-25	19.1	32.2
Rest of Industry	22.5	33.6

Concentration

Many commentators on the industry still have the misconception that the securities industry has been both consolidating and becoming more concentrated since the early 1970s. Actually, since 1978 the securities industry has been expanding. Indeed, the number of NYSE firms dealing with the public increased slightly that year as did the NASD membership. Since 1979, the number of NYSE and NASD members has been increasing.

Although the consolidation of the industry stopped about 1978, concentration continued to grow. The largest firms increased their share of total revenues, commission revenues and

total capital. In effect, the big continued to get bigger through 1982 (Table 12). This trend was reversed in the first half of 1983 with the boom in activity and securities prices. Whereas firms other than the largest 25 continued to more or less hold their own in commission revenues from 1978-1982, their slice of total revenue and total capital decreased through 1982. In the first half of 1983, their market share increased noticeably in both gross revenues and total capital. This reflected the profitability enjoyed by smaller firms during this time period and investments by other financial intermediaries in regional firms.

Table 12

Concentration Data, 1979-First Half 1983

	1979	1980	1981	1982	1H 1983
1. Total Revenue					
Top 10	48.7%	53.1%	55.6%	57.3%	54.4%
Top 11-25	18.6	19.4	18.7	18.7	19.7
Rest of Industry	32.7	27.5	25.8	23.9	26.0
	100.0%	100.0%	100.0%	100.0%	100.0%
2. Commissions					
Top 10	40.0%	43.6%	43.4%	42.8%	42.6%
Top 11-25	20.0	21.1	20.8	20.9	21.0
Rest of Industry	40.0	35.1	35.8	36.4	36.4
	100.0%	100.0%	100.0%	100.0%	100.0%
3. Total Capital					
Top 10	45.8%	50.8%	50.0%	54.8%	48.8%
Top 11-25	18.8	18.0	19.7	18.3	17.1
Rest of Industry	35.4	31.1	30.3	26.9	34.1
	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Securities Industry Data Base

Summing up, 1978 was the benchmark year when the consolidation of the securities industry was halted. For those who believe that the securities markets will be healthier with more players in that market, 1983 may well turn out to be the year where the industry became less rather than more concentrated. Nevertheless, before becoming too optimistic, we should see what happens to market share as business slows down in the 2H 1983. At the very least, we may have reached the point where further concentration in the securities industry more or less stopped.

Conclusion

The third quarter reports of publicly owned broker-dealers are trickling in. In general, these show that profitability fell relative to the 1H 1983. However, starting with the third quarter of 1982, the securities industry enjoyed a period unparalleled in revenues and profitability. These trends could not be expected to continue indefinitely.

Our earlier concerns expressed in the June issue have, unfortunately, been right on the mark. With revenue growth slowing down in the third quarter, it was just a matter of time until the higher level of costs would put a lid on industry profits. Fortunately, profitability in the latter part of 1982, through the first half of 1983, has left the industry with a stronger and larger capital base.

Although profitability for all segments of the industry are expected to be down in the third and fourth quarters, certain segments will perform better than others. In particular, firms for whom trading activity is especially important will face a more difficult period. In comparison, firms emphasizing retail activity including underwriting of equities will do better than others. Although volume may be down relative to the 1H 1983, 3Q 1983 exceeded 4Q 1982 activity. Thus, we expect lower profits in the third and fourth quarters relative to the 1H 1983, but they should be around the level in the 3Q 1982. In other words, we expect 1983 to be a record year with revenues in the $28-$31 billion range. Our best guess is that after-tax ROE will range between 24-27%, possibly exceeding the all-time high of 25.7% in 1980.

Now that the securities industry data base is "live," analysis in the future will be available faster. Moreover, as other individuals use the data base, the analysis of the securities industry should improve dramatically. This development is welcomed by all individuals in the industry as well as policymakers.

Jeffrey M. Schaefer
Senior Vice President and
Director of Research

Ira Epstein
Assistant Director
of Research

LIST OF DISCOUNT BROKERAGE OPERATIONS AS OF AUGUST 1983

Abbot Securities
Adams, Harkness & Hill
Adams, James, Foor & Co., Inc.
Advest, Inc.
Allen & Company

Allied Securities Corp.
American Commercial Securities Corp.
C. D. Anderson & Company
Anderson, Tallman & King
Arbour Securities

Argus Securities
Aristo Investment of America
Arlington Inter-Urban Securities
Arnold Securities
Baker & Company

Barclay Financial Corp.
BBS Equities (Bevill, Bresler & Schulman, Inc.)
Berlind Securities
Bishop, Ramirez-Simsco., Inc. Investment Securities
Richard Blackman & Company

Blinder, Robinson & Co., Inc.
Brokers Exchange, Inc.
Brooks-Campbell & Co., Inc.
Brown & Company Securities Corp.
Bruno & Stolze

Burke, Christensen & Lewis Securities Corp.
Alan Bush Brokerage Company
W. T. Cabe & Company
William Cadden & Company, Inc.
Capital Discount Brokerage, Inc.

Capital Express Corp.
Capitalquest Securities, Inc.
Carnegie Investor Services, Inc. (sub. of Gilford Securities)
Chayka & Loeb
Clayton, Polleys & Company

Julien Collins & Company
Columbine Securities
Commission Discount Corp.
S. C. Costa Company
Crailin & Company (formerly Forbes, Walsh & Kelly)

Daley & Company
Marquette deBary Co., Inc.
Dis-Com Securities
Discount Brokerage Corporation of America
Discount Investments of America (Subs. of Home Savings)

Dominick & Dominick
Downstate Discount
Eastern Capital
Eastwest Securities Company
Elliott Securities, Inc.

W. N. Estes & Co., Inc.
Exchange Services
Fidelity Brokerage Services, Inc.
John Finn & Company
First Affiliated Securities, Inc.

First Birmingham Securities Corp.
First Discount Securities
First Georgetown Securities
First National Securities (formerly First Omaha Securities)
First Union Discount Brokerage Services

Freeman Welwood & Company
FSC Securities Corp.
Goodson Securities
Grimm & Davis (Div. of Douglas Stewart)
Haas Securities

Haigney Securities
Heartland Securities
Heitner Equities
Heritage Investment Securities, Inc.
Jerome Hickey Associates

Icahn & Company
Individual's Financial Services, Inc.
Individual's Securities
Intrawest
Investacorp, Inc.

Investors Associates Incorporated
Kall & Company
Kashner Securities Corp.
Kenneth Kass & Company, Inc.
Kennedy, Cabot & Company

KO Securities
Kramer Securities Corp.
R. F. Lafferty & Company, Inc.
LaSalle Street Securities, Inc.
Lind-Waldock

Liss, Tenner & Goldberg
Little & Company
Madduff & Sons
Marsh, Block
M. H. Meyerson & Co., Inc.

Mpact Brokers, Inc.
MSR Securities, Inc.
Barry W. Murphy & Company
Oberweis Securities, Inc.
Odd Lots Securities, Ltd.

Olde & Company
Ovest Securities, Inc.
Pace Securities
Pacific Brokerage Services
Packard & Lewis (Div. of Haas Securities)

Park Avenue Securities
Parker, Alexander & Co.
Parr Securities
Andrew Peck Associates
Pennsylvania Group

Peremel & Company
Portfolio Securities Transactions Corp.
Quick & Reilly
Recom Securities
Remsnyder & Company

Reynders, Grey & Company, Inc.
Riko Securities
Roberts Securities Corp.
Robinson Securities (Div. of John Dawson & Assoc.)
Rodecker & Co. Investment Brokers

Rose & Company
Rosenkrantz, Ehrenkrantz, Lyon & Ross
Royal Investors Group
Russo Securities, Inc.
St. Louis Discount Securities, Inc.

Salem Securities Inc.
Charles Schwab & Company
Scottsdale Securities
Sea-First Discount Brokerage
Seaport Securities Corp.

Seasongood & Mayer
Security 1st Brokerage Services
J. D. Siebert & Company, Inc.
J. Robert Sheeks & Company
Shearman, Ralson, Inc.

Shochet Securities
Muriel Siebert & Company, Inc.
Springer Investment & Securities
Stock & Trade
Stock Cross

The Stock Mart
Stock Service Corp.
Texas Securities, Inc.
Robert Thomas Securities
Tradex Brokerage Service, Inc.

Triad Securities
Max Ule
Underhill Associates
Universal Securities Corp.
Verelli, Altschuler & Schwartz, Inc.

Voss & Company
Wall Street Discount
Walnut Securities
Waterhouse Securities
Werlitz Securities, Inc.

Werbel-Roth Securities
Western Discount Securities
Westminister Securities Corp.
Jack White & Company
Thomas F. White & Company

Whitehall Securities
Wisconsin Discount Securities
York Securities
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DEREGULATION: OPPORTUNITIES AND PITFALLS

A Summary of Presentations at the 1984 Trends Conference*

The theme of the 1984 Trends Conference was "Deregulation: Opportunities and Pitfalls." This issue of Trends will summarize the conference speakers' remarks concerning deregulation in the financial services industry.

The conference addressed a large number of issues and questions, theoretical and strategic, facing the financial services industry. The most fundamental questions are: (1) what economic and structural changes has the securities industry undergone since price deregulation in 1975?; (2) what are the factors presently encouraging further deregulation in the financial services industry?; (3) how does competition in the deregulated financial services industry differ from earlier competitive trends in the securities industry?; (4) what do all the economic and structural changes in the financial services industry mean in terms of firm strategies?; and (5) how can securities firms successfully compete in the broader financial services industry environment?

The conference theme was reflected in Donald Waite's presentation "Analyzing Concepts and Strategies in Deregulated Industries." Representatives of the four types of firms Waite discussed followed with presentations focusing on strategies in a deregulated environment: Bob Rittereiser of Merrill Lynch on the national firm, Ned Johnson of Fidelity on discounters, John Castle of DLJ on the specialty firm, and Bob Woodberry of Sutro on the regional firm. Charles Brown of AT&T was the keynote luncheon speaker discussing "AT&T After Divestiture." The afternoon session focused on three strategies in obtaining capital and distribution. Chip Mason of Legg Mason spoke on "Going Public," Bobby Piper of Piper Jaffray discussed "Linking with Another Organization," and Don Kittell of Dean Witter

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* The full transcript of the 1984 Trends Conference is available at $50. Conference registrants can still obtain copies at $25. An order form is enclosed.

Securities Industry Association

discussed "Merging." The conference concluded with remarks by Albert Gordon (Kidder, Peabody) and Ed O'Brien (SIA). Gordon placed the issues presently facing the securities industry in a broader historical perspective, while O'Brien, looking towards the future, was optimistic that the securities industry will exploit the opportunities presently facing it.

Introductory remarks to the day's program were provided by Jeffrey M. Schaefer (SIA). According to Schaefer, the securities industry recently entered another stage of deregulation, characterized by the crumbling of barriers between different segments of the financial services industry. This trend is related to the great growth in industry revenues and profitability that has occurred despite the deregulation of fixed commission rates in May, 1975. Other financial intermediaries have noticed these trends and decided to enter and compete for securities activities.

ALTERNATIVE STRATEGIES UNDER DEREGULATION

Frederick J. Wilten (Pru-Bache) introduced the topic of alternative strategies under deregulation. Wilten highlighted how firms in the financial services industry can successfully compete in a deregulated environment. He addressed two questions: How did deregulation of commission rates in 1975 affect the securities industry, and what are some of the factors encouraging further deregulation?

The first phase of securities industry deregulation concerned how firms were going to compete while the second phase will determine where they are going to compete. The rigid barriers to financial industry segmentation are crumbling with banks and securities firms entering each others businesses. According to Wilten, the driving force behind this second phase of deregulation results from banks and securities firms responding to weaknesses in their core businesses.

"Analyzing Concepts and Strategies in Deregulated Industries" Waite (McKinsey & Co.)

Waite's presentation focused on the strategies most likely to be effective given the economics, structure and dynamics of the present-day deregulated financial services industry. Deregulation for the securities industry occurred in May 1975 when fixed commission rates for stock transactions were eliminated. This price deregulation had many important consequences: industry profitability and rate of return declined as the most profitable products/services were affected; products/services were unbundled and new products/services proliferated; and the variability in performance among firms increased.

According to Waite, profound structural changes occurred in the deregulated environment in three phases. The first occurred around the years surrounding the dramatic price deregulation (1973-1978) and consisted of the merging of some second-tier firms to compete against the largest firms. As a result, the industry became more concentrated. In the second phase (1978-1980), the largest firms got bigger by acquiring certain specialty firms to round out their products and services, again increasing industry concentration. With the third phase (beginning in the early 1980s), firms outside the industry combined with some of the traditional industry participants.

In addition to the macro analysis of securities industry deregulation, Waite also provided a firm-level analysis. According to Waite, in a regulated environment, most firms compete directly in core markets by offering traditional services. Under deregulation, firms begin to differentiate themselves, and compete by offering different products/services at varying prices. Four types of firms emerge from this differentiation process: the national distribution firm, the single product firm, the specialty firm, and the regional firm. Waite provides an analysis of each of those types of firms and the options available to them in a deregulated environment.

Competition in the disaggregated environment requires firms to identify all the business they are in, and those where they have a competitive advantage and disadvantage. Firms must determine which of their businesses are linked and which can stand alone in order to determine which business can be eliminated without affecting other businesses. Firms should evaluate whether they can substantially alter the economics of their businesses, by either changing their cost system or by other arrangements, such as leasing businesses or by combining distribution systems. Given resource constraints, firms should evaluate their ability to reallocate their resources and what business(es) to emphasize. Waite stressed that the strategic options available to firms are both quite limited and difficult. In the present environment of rapid change and great discontinuity, Waite concludes that it is both more difficult but also more necessary to plan.

SPECIFIC STRATEGIES

Peter Muratore of E.F. Hutton introduced panelists representing the four kinds of firms which emerge in the differentiation process under deregulation. Deregulation cannot be thought of as a simple phenomena. First, different firms experience deregulation at various times, and its impact varies by firm, being both an opportunity and a threat. Asset management, according to Muratore, has been the strategy adopted by Hutton in the deregulated environment.

"The National Full Line Firm"
Rittereiser (Merrill Lynch)

Rittereiser indicated that during the 1969-1982 period, Merrill Lynch (ML) was driven by a growth diversification strategy. ML expanded its capital markets business primarily with internally generated activities, entered the insurance and real estate fields, and developed more products aimed at cementing relationships, such as the CMA.

According to Rittereiser, regulatory barriers are eroding and will continue to do so in the future. Banks are entering the discount brokerage market. Rule 415 has greatly impacted the underwriting business. Legislation in 1982 virtually put the Depository Institutions Deregulation Committee (DIDC) in the role of a product designer for the banking industry.

For Rittereiser, the rapid developments in computer hardware and software technology are putting information and computing power closer to the end user, and driving information and financial services closer together in the consumer's mind. This trend will, for many firms in the financial services industry, drive processing costs down, and give them the opportunity to create new delivery systems.

ML also realized that it was no longer competing only against traditional brokers but also against many financial giants with capital, management, good reputations, who employ sophisticated technology, and have large customer bases.

ML sees the next few years as a volatile transition period for the financial services industry, a period during which ML can solidify its position. Though competition will be intense over the next few years, many of ML's competitors will be unable, for a number of reasons, to fully compete with ML.

Rittereiser concluded that ML has major opportunities to continue growing. In looking at future strategy, it comes down to what are you going to do about your situation. A strategic plan is a variety of ways of getting things done to handle the position you are in.

"The Discounter"
Johnson (Fidelity)

Before discussing the discounter, Johnson made three general observations concerning some of the themes previously discussed. First, he does not believe that the financial services industry lends itself to the model of corporate planning applicable to industrial corporations. Second, deregulation has already occurred and is history. Third, a far more important issue is how computer technology has increased the capital requirements and made the industry much more capital-intensive.

According to Johnson, when deregulation first began, different groups saw it having different effects: the break up of the biggest institutions; an enormous opportunity; fears that the consumer would lose government protection; severe price competition which would be self-destructive.

For Johnson, "discounting" is doing something for less money than somebody else doing the same thing. On the basis of that definition of "discounting," Johnson denies that Fidelity is in the discounting business since it is not providing the same service as everybody else. Fidelity offers different kinds of services based on different marketing techniques, described as passive selling techniques. Fidelity does not use sales representatives, but various media to sell their products/services.

According to Johnson, Fidelity's overriding strategy is to bring products to market that are good for the customer and Fidelity, distributed through multiple channels which are flexible and efficient. They sell a portfolio of products customers will buy in all sorts of market conditions. These products are sold through mass advertising, telephone sales, banks, and regional investor centers.

"The Specialty Firm"
Castle (DLJ)

Castle believes that the securities industry is far too complex to fit neatly into the model presented by Waite. Most major securities firms fall into more than one of the four basic firm categories. DLJ, for one, is both a specialty type firm and a firm that has low-cost firm characteristics. In terms of how DLJ has measured up to the ideal planning responses to deregulation as outlined by Waite, Castle believes that DLJ must be given a mixed evaluation. Their record of planning for and coping with deregulation is uneven, but they are improving all the time, and will do better in the future.

Castle discusses the impact of three deregulatory events on DLJ: elimination of fixed commission rates, passage of ERISA, and the easing of Regulation Q. According to Castle, DLJ's response was a function of its history and character. DLJ was hit hard with the great decline in institutional rates during the 1970s. Early in the 1970s, they realized that they could not rely solely on institutional business, and would have to diversify.

The institutional business remained the core of DLJ and the price cutting on institutional trades following Mayday was resisted. DLJ paid dearly for adopting that strategy in terms of market share and profitability. Those fims willing to move with the flow of events faired best. With the decline in commission rates, institutional trading grew tremendously and the large wirehouses entered this market. New low-cost producers entered

the market competing primarily on price.

With the passage of ERISA, eliminating the ability of securities firms with money management units to do their brokerage in-house, DLJ came very close to divesting Alliance Capital in 1977. However, DLJ decided to keep Alliance Capital and all trades by Alliance were distributed to other brokerage firms. This was a wise decision since Alliance's assets under management have grown 3 1/2 times since 1977. Alliance is now the largest Wall Street pension fund manager, produces a lot of commissions for other brokerage firms, and has contributed to DLJ's growth.

The DLJ that emerged out of the turmoil of the 1970s was strongly established in four principal areas of business: debt and equity trading on behalf of institutional clients, investment management for institutional customers, the correspondent brokerage system, investment banking and venture capital. DLJ added a fifth business line in 1981 when it acquired an international commodities trading firm.

DLJ is essentially a specialty firm -- a firm providing specialized, differentiated services in areas where it can make a unique contribution. In certain respects, it does not fit the McKinsey model. It evolved into a specialty firm -- not by retrenchment but by expanding into new specialty areas. DLJ expanded more through acquisitions than by internally generated growth.

"The Regional Firm"
Woodberry (Sutro)

According to Woodberry, Sutro is a small regional firm, nearly 100% owned by its employees and associates. It has a low cost operation with a good reputation. However, its processing subsidiary was only 60% owned by Sutro; the sales force is small and productivity is low; capital, inadequate. Although clearly a regional firm, Sutro would like to be a specialty firm, in a small way. Their strategy, according to Woodberry, is two-pronged. They want to remain a strong full-service regional firm; and do certain things that specialty type firms do.

To implement this strategy, Sutro bought out the 40% outside ownership of their processing subsidiary; broadened their capital from $6 million to $14 million; decided to concentrate on California only; increased their California offices to 22; tried to enhance their reputation; substantially increased the quantity and quality of their sales force; continued to put money into their operation facilities; and embarked on improving their research. They are trying to use their research product to enhance their corporate development while trying to increase institutional sales.

Thomas A. Saunders (Morgan Stanley) introduced Charles L. Brown, who spoke on AT&T after divestiture. Saunders indicated that on a worldwide basis no industry is being more deregulated than telecommunications. Charles L. Brown is leading AT&T into the new deregulated environment. As a result of deregulation, AT&T has already expanded its telecommunications activities worldwide, and has gotten into computers and software.

"AT&T AFTER DIVESTITURE"
Brown (AT&T)

The AT&T divestiture was, according to Brown, the product of government preference for competition and deregulation. What makes AT&T really uneasy is that the government has only slightly deregulated AT&T, while AT&T's competitors were deregulated to begin with. AT&T, according to Brown, is facing both regulation and competition. Brown indicates that AT&T long distance business, which accounts for about 60% of their revenue in 1983, is still fully regulated. Brown believes that there is little justification for regulation of the long distance business. He indicated that AT&T will press hard for deregulation of the long distance market. Brown hopes that competition will bring to the customer the benefits claimed.

According to Brown, AT&T management is flexible and ready to develop new strategies and to make changes according to circumstances. There is no resistance to change at AT&T. They are doing what needs to be done. Brown indicates that AT&T has already taken the following actions: an offshore strategy, which is vital to the continued funding of Bell Labs and to a good revenue steam. There are joint ventures with Phillips, and Olivetti; AT&T's large equity interest in Korea's Gold Star Company and they are now negotiating to set up a majority owned venture in Taiwan for marketing switching systems.

At home, Brown indicates, AT&T has adopted a new distribution system -- 7,000 retail stores. They believe phones will be distributed in the future this way. They are increasingly moving into a multi-functional apparatus for the home, like the Genesis System.

The competitive environment has forced them to reduce costs where necessary by closing plants and consolidating distribution facilities. They have made major structural changes: for example, they have combined their R&D with manufacturing sectors. Bell Labs is still the centerpiece of AT&T. Bell Labs, combined with AT&T marketing and production resources, provides the underpinning for the products and equipment that will be brought to the market in the new environment.

Brown indicates that AT&T's financial goals have changed to reflect their new situation. Their financial goal now is to maximize the value of their shareowners' investment. In the past, their earnings were capped by regulation, but for a large

part of the business the cap is now off. They will be striving to reach a return on equity higher than was acceptable to investors in pre-divestiture days.

STRATEGIES IN OBTAINING CAPITAL AND DISTRIBUTION

Alan F. Blanchard (Goldman, Sachs) introduced the first topic of the afternoon session, strategies in obtaining capital and distribution. Blanchard thinks that merging, linking with another firm, or going public represent strategies for dealing with the new deregulated environment. According to Blanchard, many firms in the securities industry have adopted one of these three strategies. From his 1980 list of 154 securities firms, consisting of 90% of the industry in terms of equity, 14 firms have gone public or raised additional equity money, 20 have merged, and 9 have linked.

The use of these strategies is even greater, according to Blanchard, if measured in terms of firm resources. The important question is why have so many firms decided to employ these strategies. One reason, according to Blanchard, is money. Firms that have either gone public, merged, or linked have received a lot of value, measured in four ways: dollars per book dollar, dollars per earning dollar, dollars per RR, dollars per branch.

"Going Public"
Mason (Legg Mason Wood Walker)

As an introduction to how Legg Mason made its decision to go public, Mason described his firm's corporate strategy. Legg Mason is basically a retail brokerage firm which must remain big enough so that they can compete in new products. They must stay in their own market and make money for their customers without undue risk. They have built their philosophy around value stocks -- stocks with low P/E values. They believe that the difference between them and very large firms will be that Legg Mason is geared to helping customers manage their assets.

According to Mason, the following factors were considered in their decision to go public. They are in a very volatile business and the introduction of new products can hurt the industry. The CMA basically changed the whole complexion of the industry. Another factor was the regulatory indecision in the securities industry and which new entities will enter the business and how they will enter it.

In Mason's opinion, banks have entered the securities business with no immediate plans whatsoever of making money. It's very difficult to compete in an environment when one of your major competitors is not trying to make money. Mason is also worried about the Comptroller of the Currency, the FDIC and the Federal Reserve, which he believes are protective of the banking industry. The regulators are changing the rules of the game all

the time and it is hard to make decisions in that environment.

"Linking with Another Organization"
Piper (Piper, Jaffray & Hopwood)

According to Piper, his firm did not link with the Hartford Insurance Company to obtain either capital or distribution -- their motive in linking was to protect themselves and to be able to control their own destiny.

In order to understand their motive in linking with Hartford, Piper described his firm. They are a regional firm with about 45 offices; $43 million in capital; and between 500 and 600 registered representatives. Although their activities are focused in the Upper Midwest and Pacific Midwest, they are a full-line firm; they try to run their firm as if it were a partnership.

Piper related the history of the Hartford transaction. Bache was bought by Prudential in 1981, then there were purchases of Dean Witter and Shearson. Some regional firms sold out at very lucrative prices. They owned 62% of their firm in the ESOP and felt they might be a target for a takeover. In this environment, their goal was to preserve their independence. They decided that a minority investment at a good price with protective provisions was the only way to accomplish that goal.

"Merging"
Kittell (Dean Witter Reynolds)

Kittell indicated that he will discuss mergers as a third strategy of obtaining capital and distribution from the perspective of the acquisition by Sears of Dean Witter Reynolds. Four topics will be covered: Sears' strategic decision to enter the financial services industry; Dean Witter Reynolds's decision to merge with Sears; the impact of the merger; and conclusions resulting from experience over the past two years.

In terms of Sears' decision to enter financial services, Kittell indicated three factors led Sears to look for markets other than its traditional retail market. Sears saw significant long-term pressure on the consumer disposable income base; a significant shift in priority from goods to services; and retail floor space across the country growing at twice the rate of retail sales.

According to Kittell, Sears focused on financial services for a number of reasons. Sears saw an increased demand for consumer financial services, opportunity for an outsider in the deregulated financial services industry, and Sears already possessed significant strengths in financial services (insurance, consumer credit, commercial paper, real estate). Sears had great strengths as a retailer which could be transferred to financial services.

Kittell indicated that Dean Witter Reynolds also went through the evaluation of strategic alternatives and options. Merger was not a new idea to Dean Witter Reynolds, itself the result of 13 mergers dating back to 1929. Dean Witter was competing head-on with 5 or 6 firms. The decision to merge with Sears would dramatically alter the dimensions and pace of the game. Dean Witter Reynolds evaluated the decision to merge with Sears in terms of market timing, compatibility with Sears' strategic objectives, likelihood of success, Sears' philosophy about managing an acquired entity, the impact on holding and recruiting securities industry professionals. In January, 1982 Sears acquired Dean Witter Reynolds for $610 million.

The merger had a very significant impact on Dean Witter's organization structure and its management support systems. Dean Witter reorganized around four new business units -- individual services, capital markets, consumer banking, and international.

VIEWS ON THE PAST AND FUTURE

An introduction to this, the concluding part of the conference, was provided by Richard S. Pechter (Pershing-DLJ). He indicated that Al Gordon would provide a strategic overview of what has been discussed throughout the day and would discuss the practical aspects of running a business in the securities industry over an extended period of time. He has seen everything and is able to place today's challenges and opportunities in the framework of history. Edward I. O'Brien (SIA) would discuss the challenges currently facing the securities industry.

"The Securities Industry: Yesterday and Today"
Gordon (Kidder, Peabody)

Gordon indicated that unlike most of the firms with presentations at the conference, Kidder is different: they have no outside stockholders; they have not gone public or merged; they have acquired 5 or 6 firms at book value.

Concerning planning, Gordon believes that it must not lean too heavily on rationality; planning is particularly difficult in the securities industry because of the volatility in markets and regulations. Securities firms are intermediaries who raise funds from investors for corporate or government issuers. Market volatilty was illustrated by reference to fluctuations in NYSE volume from 1929 onwards, along with price fluctuations of the Dow Jones average in the 1920s and early 1930s. Gordon also indicated that planning is difficult in the securities industry because of frequent crises. Planning requires forecasts, and accurate forecasting is a formidable task in the securities industry. Gordon does not believe we are better at it today than 50 years ago.

"Challenges Facing the Securities Industry"
O'Brien (SIA)

O'Brien is optimistic about the future of the securities industry for two reasons. First, there is increasing sophistication by clients and a growing need for financial services and for basic financial advice. Second, the securities industry is very flexible and can adapt to change quickly.

Examining what consumers want will indicate something about the future, since consumers sooner or later get what they want in our economic system. According to a Fortune magazine survey of consumer attitudes, 71% of those surveyed would not pay a premium for the convenience of one-stop financial shopping. The choice of financial service provider was made on the basis of grossly inadequate information about the services provided by financial institutions.

The industry's flexibility and entrepreneurial drive also provides for optimism about its future. The industry has been able to create and deliver many new products and services when needed, especially in the last 8-9 years. It has been able to attract talented new people. Finally, the industry has been able to greatly strengthen its capital base. Because the industry has been so creative and flexible in responding to opportunities in the marketplace in the past, O'Brien believes there is reason to be optimistic about the future.

According to O'Brien, the most important asset of the securities industry, its greatest advantage over other industries, is excellent, highly motivated individuals who do not have to work under bureaucratic conditions.

Neil L. Shandalow
Research Economist

SECURITIES INDUSTRY STATISTICS

VOLUME

	December 1983	YEAR-TO-DATE 1983	December 1982	YEAR-TO-DATE 1982	% CHG. Y-T-D 1983 - 1982
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)	88.0	85.4	76.5	64.9	31.6%
AMEX (MILS.)	6.9	8.2	7.5	5.3	54.7
NASDAQ (MILS.)	63.2	62.8	48.6	33.3	88.6
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	63,770	765,276	55,497	488,398	56.7%
AMEX (MILS.)	1,993	30,136	2,109	16,485	82.8
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,517	87,854	6,284	61,850	42.0
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	14,082	168,303	15,993	149,413	12.6
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.9	45.6	40.4	40.8	--
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	7,664	77,172	7,158	75,722	1.9
AMEX OPTIONS	3,021	34,198	3,734	38,767	(11.8)
COMMODITY	9,926	139,920	9,310	112,396	24.5

YIELDS

(MONTHLY AVERAGES)

	December 1983	December 1982	Basis Point Change
BOND BUYER INDEX (20 BOND)	9.89	9.96	(7)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.57	11.83	74
Baa CORPORATE	13.75	14.14	(39)
RATIO Aaa CORPS. TO Baa CORPS.	0.91	0.84	--
MUNICIPAL BOND YIELDS (MOODY'S)	9.34	9.34	0

PRICES

(END OF MONTH)

	December 1983	December 1982	% Change Dec. 1983-Dec. 1982
DOW JONES INDUSTRIALS	1,258.64	1,046.54	20.3
STANDARD & POOR'S 500	164.93	140.64	17.3
NYSE COMPOSITE	95.18	81.03	17.5
AMEX MARKET VALUE INDEX	223.01	169.39	31.7
VALUE LINE COMPOSITE	194.35	158.94	22.3
NASDAQ COMPOSITE	278.60	232.41	19.9

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	December 1983	Year to Date 1983	December 1982	Year to Date 1982	% Change y-t-d 1982 - 1983
NET SALES*	1,350.0	18,162.9	768.1	5,164.3	251.7
NET PURCHASE OF COMMON STOCK*	751.1	12,651.9	65.5	1,278.6	889.5
NET PURCHASE OF OTHER SECURITIES*	498.2	2,613.0	541.2	2,838.5	(7.9)
MUTUAL FUND CASH POSITION	8.8	-	8.6	-	-

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	December 1983	December 1982	% Change Dec. 83-Dec. 82
MARGIN DEBT OUTSTANDING ($MILS)	22,720	12,980	75.0
NET CHANGE IN MARGIN DEBT ($MILS)	9,740	(1,170)	-
% OF ACCOUNTS WITH EQUITY UNDER 40%	10	9	-

UNDERWRITING
(DOLLARS IN MILLIONS)

	December 1983	Year to Date 1983	December 1982	Year to Date 1982	% Change Dec.-Dec.	% Change 1983 - 1982
CORPORATE FINANCING (Gross New Issues)						
Total	5,905	99,533	10,179	78,987	(42.0)	26.0
Negotiated						
Common Stock	2,281	38,653	3,224	16,492	(29.3)	134.4
# Of Common Stock Issues	135	1,566	106	680	27.4	130.3
Preferred Stock	318	8,656	487	5,298	(34.7)	63.4
# Of Preferred Stock Issues	8	130	15	96	(46.7)	35.4
Corporate Debt	3,306	52,223	6,468	57,195	(48.9)	(8.7)
# Of Corporate Debt Issues	37	606	61	642	(39.3)	(5.6)
MUNICIPAL FINANCING* (Gross New Issues)						
Total	9,461	116,969	11,068	117,793	(14.6)	(0.7)
Notes	1,923	35,759	2,890	42,916	(33.5)	(16.7)
Bonds	7,538	81,210	8,178	74,877	(7.8)	8.5
# of Bond Issues	478	5,750	549	5,561	(12.9)	3.4
Negotiated Bonds	6,316	59,652	6,265	50,768	0.8	17.5
Revenue Bonds	6,770	58,780	6,407	51,810	5.7	13.5

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Third Quarter 1983	Yr.-to-Date 1983	Third Quarter 1982	Yr.-to-Date 1982	% Change 3rd Q.1983 3rd Q.1982	% Change Yr.-to-Date 1983-1982
REVENUE						
SECURITIES COMMISSION INCOME	1,977	6,480	1,479	3,751	33.7%	72.6%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	1,707	5,913	1,786	3,656	(4.4)	61.7
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	872	2,718	595	1,391	46.6	95.4
TOTAL REVENUE	7,136	22,298	5,903	15,391	20.9	44.9
TOTAL EXPENSES	6,399	18,804	4,933	13,960	29.7	34.7
NET INCOME BEFORE TAXES	737	3,494	970	1,431	(24.0)	144.2
PERCENT OF FIRMS SHOWING LOSS	24.3%	--	16.0%	--	--	--

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
SIA Position Paper on Preservation of Access by U.S. to Foreign Capital	Paper analyzes the three current viable means of preserving access to foreign capital: Netherlands Antilles Treaty, Chafee-Bentsen/Gibbons-Conable Bills, and the Barnard Bill. SIA strongly supports Chafee-Bentsen/Gibbons-Conable bills because of the resulting broader, free market, long term consequences. However, to the extent such legislation cannot be achieved, a narrower approach as incorporated in Barnard's bill is supported.	Research Department SIA
"Window Shopping With Shelfs" "A Green Light for Shelfs, But With If Clauses"	Rule 415 deals peaked early in 1983, with shelf users taking advantage of market windows. These convenience shelfs lacked the characteristics of the real thing and exaggerated the volume numbers for 1983 shelfs. If the new SEC provision intended to prevent convenience shelfs is heeded, 1984 shelfs may be near to nothing. Second article summarizes due diligence guidelines of SEC for shelfs.	Investment Dealers' Digest 1/10/84
"Deals of the Year"	Chart depicting 50 biggest deals, M&A's and securities offerings, in 1983, with data on financial intermediary handling the deal and fee. 1983's 50 biggest deals totaled $38.4 billion, and total financial intermediary fees topped $260 million.	Fortune 1/23/84
"Background for Those Record Deficits"	Concise chart and tables tracing Federal surplus and deficit from 1929 through 1982 by Administration and as % of GNP, with select summary points. While neither political party has had any particular monopoly on budget balancing, the 1982 deficit-to-GNP ratio, 4.8%, surpasses both the previous peacetime high deficit (4.5% in 1975) and the 4.4% ratios set in the Great Depression.	Tax Notes 1/2/84

ITEM	DESCRIPTION	SOURCE
"How the institutions rank the top brokerage firms"	Ninth annual survey of largest institutional investors' ranking of top ten brokerage firms in terms of: 1. overall best service, 2. most useful research, 3. accessibility of key personnel, 4. order execution and 5. handling of block positions.	Financial World 1/11/84
"Inside the Goldman Sachs culture"	Article attempts via firm interviews to identify factors which make up the "GS culture", such as teamwork, homegrown talent, and decentralized management. Concludes that driving force of GS is in the sense of common cause in its people, on which future success will depend.	Institutional Investor January, 1984
Marketing Financial Services (by Robert Perez)	As a result of increased competition following financial services industry deregulation, and reduction of barriers between segments of the industry, firms in the industry have increasingly adopted marketing activities. This book examines the marketing concepts/methods/activities (product design, price, place, promotion) used by the major segments of the industry: commercial banks, savings banks, life and casualty insurance companies, mutual funds, securities firms and pension funds. Concludes with a discussion of future marketing trends in the financial services industry.	Praeger Publishers 521 Fifth Avenue New York, NY 10175
The Financial Health of Canadian Corporations	A 36-page research report determining that Canadian corporations are excessively debt financed. Predicts $40 billion of new equity is needed in 1983 and 1984 combined to reach reasonable targets for debt/equity ratios and growth in business assets. Offers suggestions on creating a public policy environment to sustain record levels of new share capital raised in 1983.	The Toronto Stock Exchange January, 1984